

Oct. 20, 1999

LETTER 1289

THE PICTURE: I've said all along that this bear market would start with an extended period of **erosion**. And that's exactly what we've been seeing. No dramatic crash yet, no shocking one-day declines yet, just persistent, relentless erosion -- as best gauged by the dreadful action of the advance-decline ratio.

But make no mistake about it, the bear is also knocking off the big stocks one by one -- IBM, XON, INTC, WCOM, C, CMB, HWP, BAC, MRK, GT, BLS, T, FNM, AIG, F, GM, RTNB, one by one by one they're going, going -- slowly eroding away.

One of the characteristics of great bull and bear markets is that they tend to **carry further (in extent) and longer (in duration) than anyone believes possible**. Moreover, the gradual turn from bull to bear can stretch out for many months -- although the turn from bear to bull is usually much faster.

In the last Letter I included what I termed my "top-out parade." I showed that index after index and stock average after stock average have already topped out. Nevertheless, it's been a subtle series with few people realizing what was happening. Even now I don't hear anyone talking about the extended series of top-outs, a series which includes the new highs, the advance-decline ratio, the Russell 2000, the Transportation Average, the Utility Average, the NYSE Composite, the S&P 500 and so forth.

Yet, as I see it, this is all part of a gradual process, which I call **"the slow death of a great bull."** What happens is that the "big money" realizes that the market has already discounted the best that lies ahead. Sophisticated investors know that when business is running at white heat, **when business can't get any better -- then only one direction remains -- and that direction is down.**

But "down" can take time, often a lot of time. The upward momentum of many years isn't going to be reversed in a week or a month. As big money and large investment interests slowly and systematically move out of stocks -- one group, one index, one average -- one by one they give up the ghost. Finally, the bearish evidence becomes too **blatantly obvious**, and the entire market heads down.

Question: Russell, you say we're in a primary bear market. How or when can we be sure of that -- and what would have to happen to prove you wrong?

Answer: Easy, if the Industrial and Transportation Averages turn around and advance to new highs, I will obviously have been very wrong. But I really don't think that's going to happen.

Here's what I do think will happen. The bear will keep himself as disguised as possible for as long as possible --

Oct. 8 DJIA 10649.76; PTI 5262; A-D Ratio -1.72
Oct. 15 DJIA 10019.71; PTI 5233; A-D Ratio -3.18
Dow Yield: 1.74%; Dow Price/Earnings: 22.5
Dow 144-day MA: 10717.90; Dow 34-day MA: 10596.50
Dow Times Book Value: 5.92; PTI 89-day exp. MA: 5308
Percentage of Undervalued Blue-chips: 9%
Gold 34-day MA: 284.8

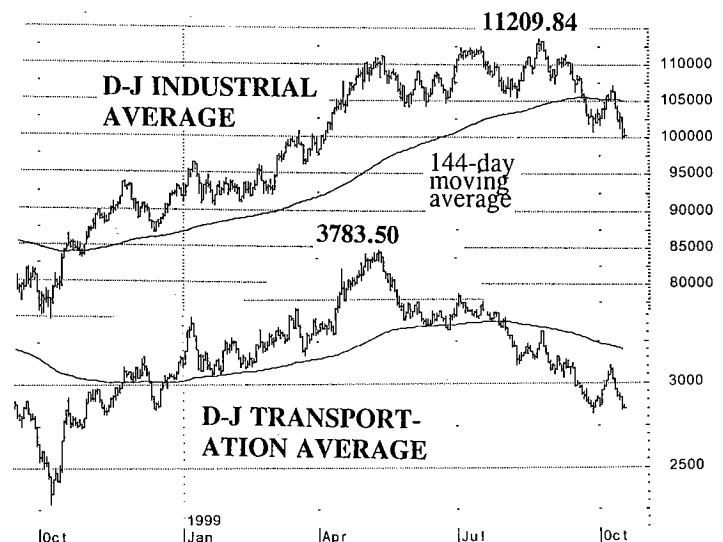
which means doing whatever he has to -- to keep investors optimistic, hoping and, of course, buying.

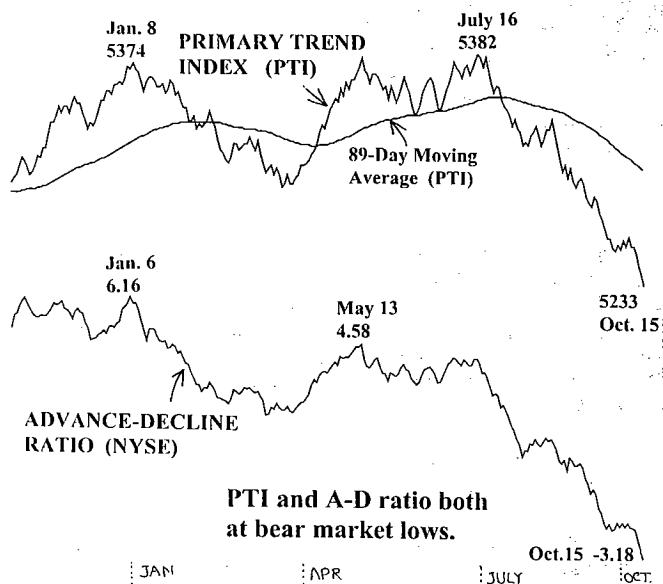
To do that the big averages, the Dow, the S&P and the Nasdaq cannot be allowed to "fall apart." And so far, the bear has done a great job. While the majority of stocks are down 20%, 30% and more from their highs, the public's attention is directed to what's still looking good, and that means concentrating on the big stock averages, the tech stocks and many Internet stocks.

But to me what's so incredible is the refusal of the media to even mention the words bear market. If I didn't know better, I'd almost think it was a conspiracy. But of course, it's not a conspiracy, it's simply a mixture of ignorance, stubbornness and just plain arrogance. It's as though -- if they didn't mention the word "bear market," somehow the bad bear will go away. It's not going to happen. The media obviously has a vested interest in bullishness -- but the bear market couldn't care less. And believe me, in the end, the bear will make the media and everyone else PAY for their incredible arrogance and ignorance.

If I'm correct about this being a bear market, then we've already seen the highs in almost all the averages and indices, and it's just a matter of time before they break down big-time, break down in much the same way that the advance-decline ratio has already broken down.

From the bearish viewpoint, I really don't care what the averages do this side of the highs. They can whip back and forth, they can drift about in a trading range, they can





gradually sink, they can do anything they want -- as long as they don't break out to new highs.

What I'm saying is this -- the bear is taking over. The averages and indices have seen their highs. What's been happening so far is **gradual erosion**. But the die is cast. The fate of the market is SET. However, the form that the bear market will assume is not set. The market is going down, but just how and where and when it goes down, I wouldn't presume to tell you. In fact, that's the main reason I write my daily reports on the Internet. I write those dailies to try to keep my subscribers up to date on the daily action and the meaning of the daily action.

By the way, it's the **inevitability thesis of Dow Theory** that is the most difficult for the investors to accept. "How can the die be cast?" argues the investor, "Nothing is set in stone. If the market heads down, the Fed will do whatever it has to -- to turn the situation around."

And the Dow Theorist replies, "When the primary trend turns down, a bear market is in force -- and the bear trend is fated to run to conclusion. It will run to conclusion no matter what the Fed does, no matter what the public does, no matter how sentiment gyrates, no matter what Congress or the President or the Treasury do. The bear market will express itself fully no matter what. The bull is slowly dying, the bear is now emerging from his lair, and there's no way of reversing the basic situation -- our job is not to argue with the bear, our job is to protect ourselves from whatever trouble and problems lie ahead."

NOTES: As an aside, I'm frankly amazed at the persistence of bullishness in this market. The market can decline for a few weeks with the breadth continuing down, and with a two-day rally, everyone is bullish again. Truly extraordinary -- the ingrained bullishness today is just amazing.

One reason for the bullishness is probably the rise of the Internet. There's no question about it, the net isn't just another innovation, it's a revolution, and it has sparked huge enthusiasm on the part of Wall Street and investors in general.

As to the Internet stocks, my guess is that 6, 8 or 10 net stocks will ultimately dominate the web, while the rest, maybe 80%, will struggle or even become history. One factor now is that advertisers (and that's where most of the net income has come from, so far) will be directing most of their spending to the big net outfits, the ones that have the widest coverage. This means to stocks like Yahoo and AOL and AMZN, the clear leaders. To my mind, however, it isn't a question of how big the Internet is fated to be (it will obviously be HUGE), it's a question of who will rule the net and whether they can ever generate enough in profits to justify their prices.

INVESTMENT POSITION:

Short and sweet. The bear is in the box. A bear market is on. Neither the duration nor the extent of the bear market can be known in advance. My suggestion -- move to T-bills or short T-notes. **Remember, in a bear market valuations deteriorate through time.**



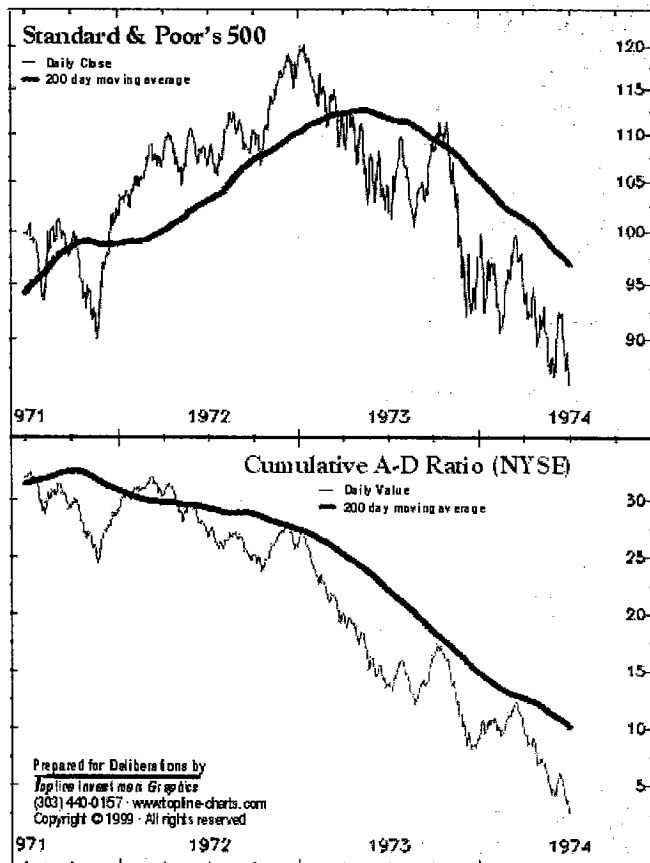
The brokerage stocks are obviously the closest stocks to Wall Street. By nature, they tend to be extremely sensitive to market conditions as they will materialize in the period ahead. Warning: Many of the brokerage stocks have already lost up to 50% and more of their value -- DLJ down 63%, E*trade down 70%, MER down 35%, AGE down 35%, Schwab down 58%, Ameritrade down 73%. Mull it over.

MORE ON PRICE/BREADTH: I've repeatedly directed subscribers' attentions to what I consider one of the most important technical relationships in the stock market; it's the relationship between the big averages and the great majority of stocks on the NYSE, the latter as gauged by the advance-decline ratio.

The accompanying page 3 charts were created by my old friend, John Carder, in my opinion the best and most original chartist in the nation [*Topline Investment Graphics*, (303)440-0157]. Here we see a fascinating comparison of the 1971-74 price/breadth situation -- with the price/breadth situation today.

Turning to the 1970s chart, note that the A-D ratio topped out in April 1971 and then headed down into what can only be described as an historic breadth collapse. While this was happening, the S&P was tracing out a huge "head-and-shoulders" top. The S&P hit a high in January 1973 -- then it too turned down. Towards the end of '73 the S&P broke wide, following which the S&P embarked on an historic decline along with the still collapsing A-D ratio.

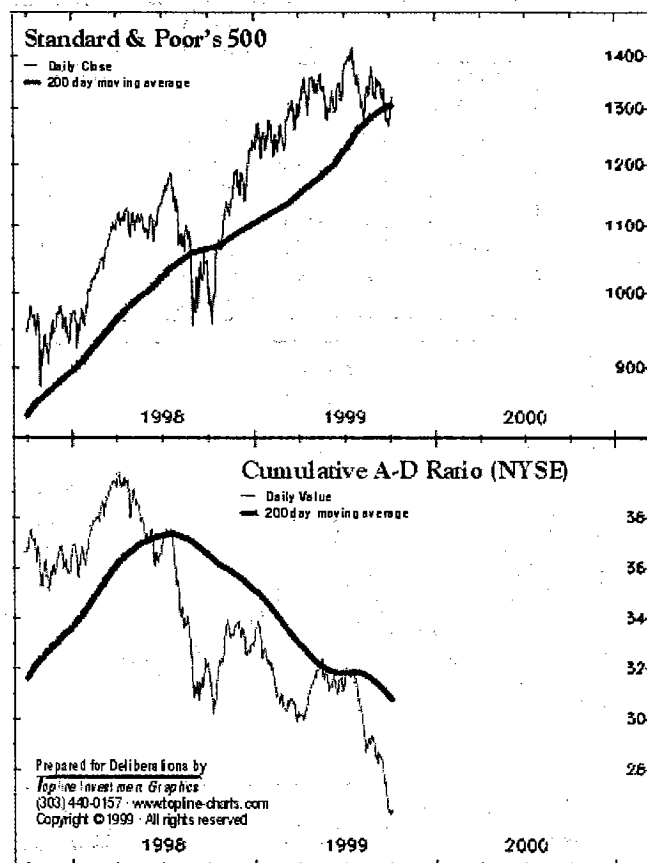
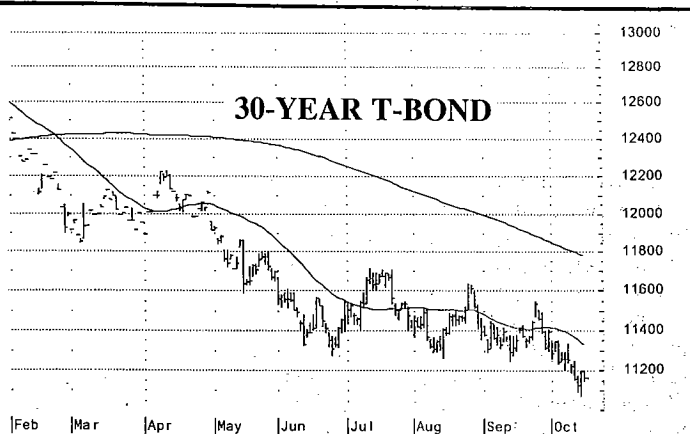
Now turn to the chart of the '90s. Here we see the A-D ratio topping out on April 3, 1998 and then heading steadily lower. Despite the A-D ratio decline, the S&P has continued to advance. The S&P struck a record high of 1418.78 on July 16, 1999, then it too turned down. Note that the S&P has now traced out a small head-and-shoulders top-pattern, but so far the S&P has not broken decisively -- a breakdown would require that the S&P drop to the 1250 level.



Incredibly, however, even as this is written the A-D ratio continues to sink to new lows. The wider the space between the S&P and the A-D ratio, the greater the "technical vacuum" or strain on the market.

Frankly, I've never seen such a wide divergence between the major averages and the great majority of stocks (actually, there's never been one this wide). At the same time, bullishness continues to be concentrated in a few groups of stocks --namely, the techs and the Internets.

How will it all end? Ultimately, the market will move to a state of harmony, a state where the big averages and the majority of stocks are acting as one. In the past, where divergence has existed, this has always resulted in the big averages coming down to meet the breadth. The reason is that there's more pure power in the great mass of stocks than there is in the S&P or the Dow alone.



SQUEEZE: Nobody, it seems, watches the money supply any longer (although 20 years ago Wall Streeters would breathlessly await the latest money supply figures). John Carder just sent me the page 4 chart of the real (inflation adjusted) broad M-3 money supply.

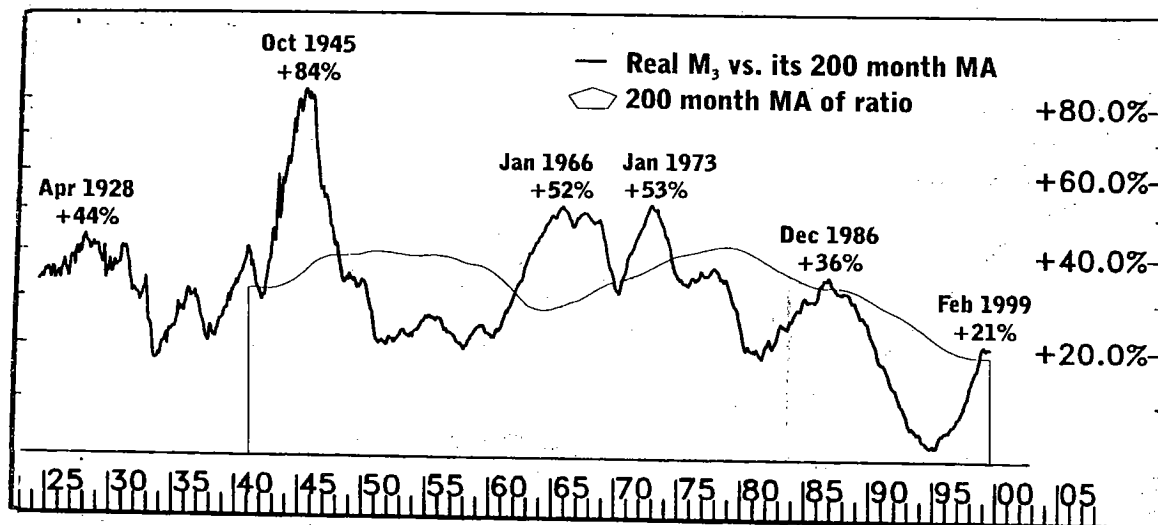
This is the story of five previous money-supply peaks, plus the most recent peak which occurred in February 1999. The statistics for each peak and its aftermath are shown in the accompanying box. Note that following each M-3 peak, the Dow lost anywhere from 87.4% (1929-32) to 20.1% (1946-49).

The most recent situation runs as follows: the M-3 money supply peaked in February 1999. Six months later, on August 25, the Dow hit a record high of 11326.04. If history repeats, the stock market should be in increasing trouble. And it remains to be seen whether the Dow will follow the previous post-peak downturns, the mildest of which was the 20.1% drop of 1946-49.

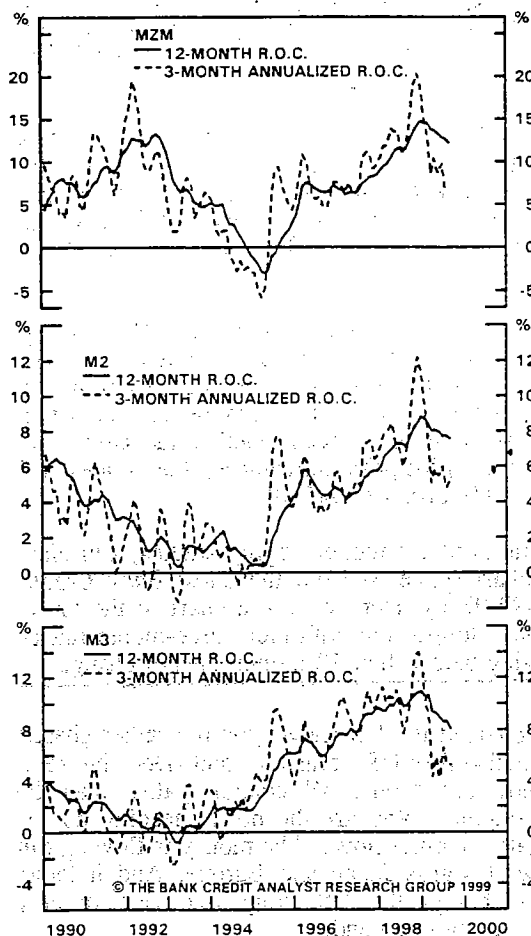
Confirming John Carder's money supply studies, I'm also including this chart (page 4) from the latest *Bank Credit Analyst* [(514)499-9706]. Here we see a chart of the three Ms. All three have topped out with their three-month rates-of-change plunging below their 12-month rates-of-change.

BONDS: The chart at the left shows you the rather ghastly decline in the bellwether US Treasury bond (Dec. futures). This bond is now based on a 6% coupon (rather than the previous 8% coupon). Why are the bonds heading down? My guess, negative capital flows. The money is flowing out of the US now, towards Japan and Europe. And it looks increasingly as though the US' long free ride (money flowing in) is coming to an end.

Peak of M3 Ratio	DJIA Peak monthly average basis			Subsequent Decline monthly average basis			
	Date	Value	Months After	Loss (Percent)	DJIA Value	Date	Duration
Apr 1928	Sep 1929	365.27	17	-87.4%	45.97	Jul 1932	34
Oct 1945	Jun 1946	207.32	8	-20.1%	165.59	Jun 1949	36
Jan 1966	Dec 1968	968.39	35	-28.5%	691.96	May 1970	17
* Jan 1966	Jan 1966	985.93	0	-29.8%	691.96	May 1970	52
Jan 1973	Jan 1973	1026.82	0	-41.9%	596.50	Dec 1974	23
Dec 1986	Aug 1987	2655.01	8	-28.1%	1910.07	Dec 1987	4
? Feb 1999	Jul 1999	11052.22	5	?	?	?	?



Money Growth



NOTES & QUOTES: Call it anything but a bear market. But with the advance-decline ratio collapsing, with the Dow down over 1100 points, with the Transports down 23%, with the majority of stocks showing a loss for the year -- the *LA Times* (Oct. 14) comes out with this headline. Is this just a "pullback"? Why that's an insult to the bear. The euphemisms and double-talk continue. Believe me, the media, with its flagrant avoidance of the truth, is not doing stockholders any favors. I believe that the current dishonesty of both the media and the experts will come back to haunt everyone.

Pullback May Be Picking Up Steam

■ **Markets:** Analysts say recent trading could indicate more losses ahead when 'weak' holders dump shares.

By WALTER HAMILTON
TIMES STAFF WRITER

What could be worse than Wednesday's broad-based stock market loss? The fact that the

are persistent day after day," said John Bollinger, a well-known technical analyst and president of EquityTrader.com. "We're probably just getting underway here."

Many professional investors were caught off guard Tuesday when the market declined sharply after last week's rebound. The Dow Jones industrials slid 231.12 points Tuesday, the worst one-day point loss since May. The Dow had surged 377 points last week.

according to technical analysts who look for clues about the market by studying price patterns on charts.

Late last month, the Dow broke below a "support" level of about 10,500. A support level is a point at which an index or stock has historically rebounded from sell-offs.

The Dow rose back above 10,500 last week. But with this week's plunge, 10,500 now appears to have become a "resistance" level—a line

The battle of the on-line brokers is growing fiercer. Several of the biggest on-line outfits are talking about tripling their advertising spending over the next year or so, and this includes Ameritrade, Waterhouse, and National Discount Brokers. Everywhere you look you see those ads for brokers and their latest bargains. In their frantic effort to pick up customers, they're now signing up celebrities (Geena Davis on Waterhouse, Anna Nicole Smith on for E*Trade, Anna Kournikova in a ridiculous ad for Schwab). The brokers will spend over a billion dollars in ads this

year. Ameritrade has warned analysts that it will spend about \$500 to obtain each new customer. E*Trade says it will spend about \$300 million this year, that would be more than Merrill, Paine Webber, and Morgan Stanley combined. It's a war of attrition, and you have to wonder what happens when the bear market finally takes hold and volume drops off. Note: There are about 50 on-line brokerage firms with national ambitions and about 130 firms of all kinds in total.

Meanwhile, the NYSE makes plans to go public. The fact that the asking price for a seat on the NYSE is at \$2.6 million, a record high, tells us that the seat holders expect to share in a future bonanza when the NYSE finally puts its stock on the market for you and I to buy.

Everyone knows that the government's statistics on inflation have been phony. Their statistics have totally missed the inflation in assets such as in housing, collectibles, jewelry, plus the rise in everyday costs such as movie tickets, sports tickets, many food items, plus gasoline, rents, medical costs, etc. Finally, a few weeks ago, gold surged, but this was ascribed simply to the central banks easing up on some of the selling pressure.

What's obvious (at least to me) is that Greenspan and the Fed are deadly afraid of being accused of sticking the pin in the stock market balloon. Greenspan is well aware that he's dealing with a giant stock market bubble, and he's also aware that once the stock market heads down in earnest, he may not be able to reverse the situation. Therefore he is taking the gamble (which he has done since December 1996) of allowing the market to run.

My own feeling is that I don't care what the Fed thinks or what Greenspan does. Once the major trend of the market is set, that's the way the market will ultimately go -- although there will be many sidetracks, many counter-trend moves. It's the nature of the stock market to confuse and confound both the bulls and the bears. In fact, historically, the stock market is in trading ranges two-thirds of the time against the one-third of the time when the market is moving strongly on a trend basis one way or the other.

The most difficult process is to be able to wait through the long periods when the market is acting deceptively, moving aimlessly or counter to the main trend. This is easier to do during a bull market when the stockholder is at least being compensated with dividends while he is waiting (and remember, assets tend to increase over time in a bull market). But in a bear market the waiting is more tedious, since, ideally, during a bear market the investor is out of stocks and sitting (often impatiently) on the sidelines.

Want interesting odds on the coming political elections? The Iowa Electronic Market (it's on the net) shows bid-and-asked prices for the various candidates. You can get bid-and-asked on the candidates and you get back one dollar after the election. Samples: Hillary's is now at 33 cents and Giuliani is at 58 cents (you have to put up 58 cents on Giuliani to get back a buck after the election is over). Gore goes for 63 cents against Bradley at 37 cents. Bush is at a high 75 cents against Dole's 12 cents and Forbes at 5 cents.

Does LA care that the next NFL franchise goes to Houston? Nah, they don't. LA has the weather, the beach, a big Latino population and baseball, basketball, hockey and,

maybe most of all, soccer. They also have a very bad taste from the NFL due to Al Davis and his Raiders moving out, in, out, in, etc. Furthermore, California cities, leading a new trend, don't want to lay out any more money for sports franchises. The Houston guys paid an incredible \$700 million for their new team. Of course, they also got a \$310 million new stadium that will be built with \$195 million in public funds. The whole Houston-NFL deal will be worth over \$1 billion. It's an amazing deal because the new owners have no team, no name for the team, no players and no stadium -- yet. They better hope the economy holds up. Why would any group get into this kind of a deal? Said the new owner, business man Bob McNair, "I'm a sportsman from Houston, I'm not in this to get rich." **Russell Comment:** Hey, I like his attitude.

According to *Crain's* magazine (which is all about NYC), "With the securities industry enjoying record earnings, Wall Street bonuses this year are likely to be the biggest ever. 'The general public is going to be stunned by the amount of money people on Wall Street will make,' says Alan Johnson, a Manhattan compensation consultant who advises many of the top securities firms. Barring a total market melt-down, year-end bonuses are expected to rise to an average of 25% to 30%. At least 2,000 people on Wall Street will earn \$1 million or more in 1999, up from just over 1,000 last year, Mr. Johnson predicts. As many as 75 executives will make more than \$10 million, quadruple the number who earned eight figures in 1998." **Russell Comment:** You can see why Wall Street loves to be bullish. Bullish is where the money is. Bearish? They never heard of the word bearish, and who can blame them.

Germany and France are still locked into stultifying rules and regulations. The latest is that the Germans want to lower the retirement age to 60 as a way to fight unemployment. At the same time, a government bill in France would drop the work-week to 35 hours a week. You have to wonder how these two nations plan to compete in a world where most people are working longer and harder.

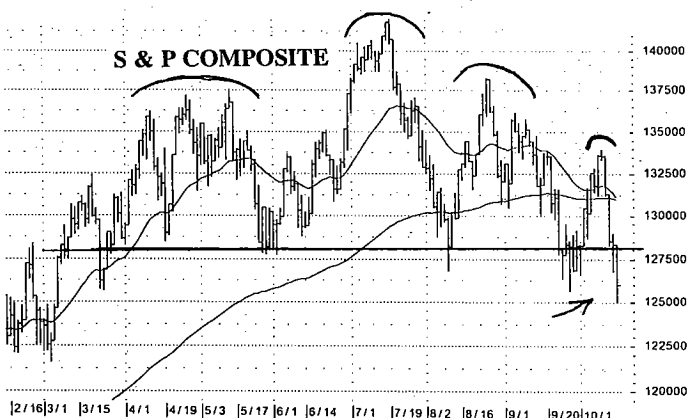
Within the course of one week, Greenspan warned at two successive bankers' meetings that they must take risk into account. Without saying that equity prices were too high, Greenspan reiterated that both bankers and investors must take the risk premium into account. Reading between the lines, it seemed to me that Greenspan was saying, "I see inflation heating up; interest rates are heading up; there is far too much debt out there and neither bankers nor investors are situated for a major decline in the stock market. But I can almost guarantee that it's coming." Of course, that's only the Russell interpretation of what Greenspan was saying, but I really think that I've interpreted him correctly.

CHARTS: Talk is talk, and, as those who watch CNBC know, talk may not be worth very much. But charts are facts in visual form. Charts don't lie, it's only the people who interpret the charts who are occasionally tempted to, er, fib.

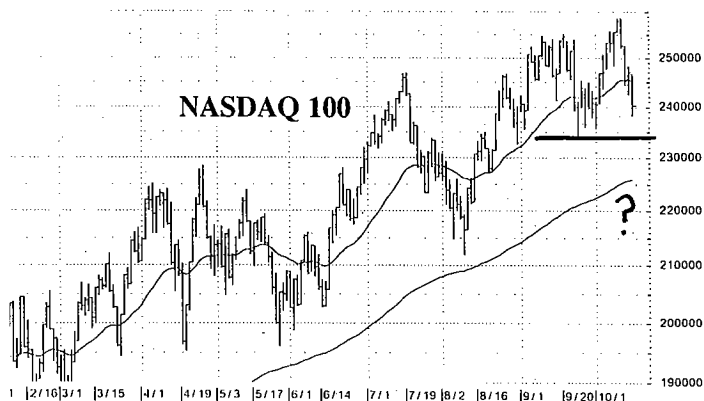
Next are some key charts that I wanted to analyze in my own inimitable (and, of course, always honest) way.

The first chart shows the S&P 500. Here we see the head & shoulders top, and the breakdown of Friday, Oct. 15. Note

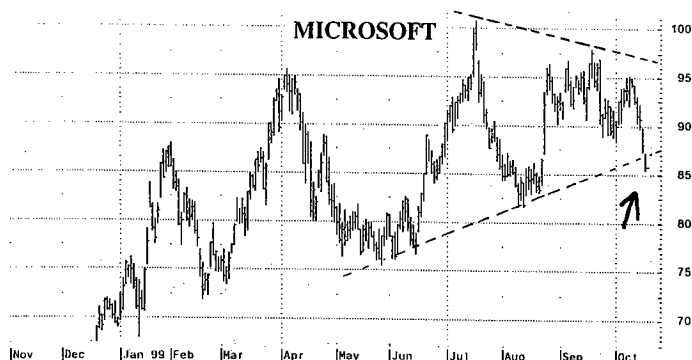
that the 34-day exponential moving average is just about to sink below the longer 144-day exponential MA. When this occurs, I always take it as an invisible technical ceiling closing over the item. The primary direction of the S&P is now bearish.



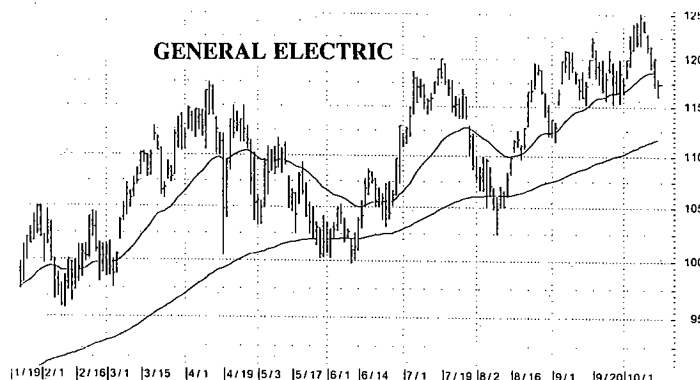
The real strength of this market has really resided in the **Nasdaq 100**, the current version of the old "Favorite 50." This average contains most of the "hot" tech stocks. When the Nasdaq finally tops out, the last holdout against the bear will have been beaten. Note that the 100 has already topped below its 34-day MA. This shows weakness, but a more important sign of a breakdown would be the 100 closing below the Sept. 24 extreme low of 2345. The 144-day MA stands at 2259.



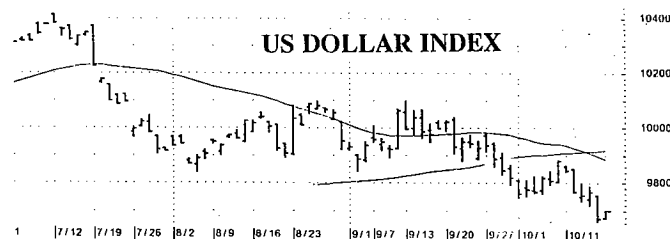
The most important single stock in the nation and certainly the largest-cap stock is Microsoft. It looks to me as though MSFT is in the process of topping out. The stock has formed a huge symmetrical triangle, always an important formation. On Oct. 18, MSFT broke out of the triangle on the downside. Based on the break, I would think MSFT would now test the 81 level, and, breaking below 81, MSFT would be in line to test the 75 level. At any rate, I think it will be a long time before we see MSFT back near its July high of just over 100.



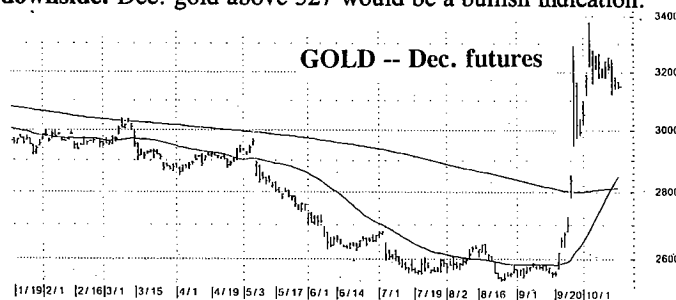
The second most important stock is, in my opinion, GE. This stock is still bullish, but it will begin to turn bearish if the stock breaks below 115. Of course, the major bear signal for GE would be a close below 100. It will take a lot of market weakness to drive GE below 100, but who knows -- this could be a very big bear market. The 34-day exp. MA for GE is still well above its 144-day exp. MA.



With both the US trade balance and the US current account severely negative, the "achilles heel" of this market may well be the collapsing dollar. This is the Dollar Index, and as you can see, the 34-day MA has now bearishly dropped below the 144-day MA. I call this cross-over action by the MAs the technical "kiss of death."



GOLD: Gold hit a 20-year low on August 25, the same day that the Dow recorded an all-time high. As you can see, Dec. gold has made a "power move" to the upside, with two huge gaps along the way -- which I don't think will be filled. The moving averages have crossed and assumed the bullish mode. It would be discouraging to see gold sink below 300, and highly encouraging if gold could break out again, this time above 340. Most encouraging item -- gold has already worked off its overbought status -- and it did it **without giving up much on the downside**. Dec. gold above 327 would be a bullish indication.



LATE NOTES: Whenever things get hairy in the stock market, Goldman drags out Abbey Cohen to tell their sales force (and the world) that everything is OK and that "the S&P is slightly undervalued." Is she right? Does the bear care? We'll see, won't we. **Russell Opinion:** The S&P at 30.4 times earnings and yielding 1.33% is grossly **overvalued**. Is Cohen factoring in the projected rate of earnings? Probably, but projected growth rates have nothing to do with value. Projected growth rates are a guessing game -- and they can change.

NEXT MAILING: Nov. 3, 1999